

CITY OF SOMERVILLE, MASSACHUSETTS

***REPORT ON EXAMINATION OF
BASIC FINANCIAL STATEMENTS***

FISCAL YEAR ENDED JUNE 30, 2005

CITY OF SOMERVILLE, MASSACHUSETTS

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JUNE 30, 2005

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Independent Auditors' Report

To the Honorable Mayor and Board of Aldermen
City of Somerville, Massachusetts

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Somerville, Massachusetts, as of and for the fiscal year ended June 30, 2005 (except for the Somerville Contributory Retirement System which is as of and for the year ended December 31, 2004), which collectively comprise the City's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the City of Somerville, Massachusetts' management. Our responsibility is to express opinions on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Somerville, Massachusetts, as of June 30, 2005 (except for the Somerville Contributory Retirement System which is as of December 31, 2004), and the respective changes in financial position and cash flows, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2006, on our consideration of the City of Somerville, Massachusetts' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's discussion and analysis, located on pages 3 through 11, and the schedule of revenues, expenditures and changes in fund balance – general fund – budget and actual, located after the notes to the basic financial statements, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

February 21, 2006

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Management's Discussion and Analysis

Management's Discussion and Analysis

As management of the City of Somerville, we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City of Somerville for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented in this report.

Financial Highlights

- The assets of the City of Somerville exceeded its liabilities at the close of the most recent fiscal year by \$143.9 million (net assets). Of this amount, \$36.0 million (unrestricted net assets) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's net assets increased by \$9.8 million. This increase is attributable to better than expected collections of fees and building permits, additional lottery money, the sale of capital assets, strong tax lien activity and the purchase of capital assets with current year resources other than debt.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$36.1 million, an increase of \$5.4 million in comparison with the prior year.
- At the end of the current fiscal year, undesignated fund balance for the general fund was \$11.4 million, or 7.6 percent of total expenditures.
- The City of Somerville's long-term debt decreased by \$3.5 million during the fiscal year. The key factor in this decrease is the net effect of the pay down of debt and the issuance of \$1.2 million in MWRA bonds.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City of Somerville's basic financial statements. The City of Somerville's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. The new approach focuses on both the City as a whole (government-wide) and the fund financial statements. The government-wide financial statements provide both long-term and short-term information about the City as a whole. The fund financial statements focus on the individual parts of the City government, reporting the City's operations in more detail than the government-wide statements. Both presentations (government-wide and fund) allow the user to address relevant questions, broaden the basis of comparison and enhance the City's accountability. An additional part of the basic financial statements are the notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The *government-wide financial statements* are designed to provide readers with a broad overview of the City of Somerville's finances, in a manner similar to a private-sector business. The statements provide both short-term and long-term information about the City's financial position, which assists in assessing the City's economic position at the end of the fiscal year. The statements are prepared using the full accrual basis of accounting. All revenues and expenses connected with the fiscal year are considered even if the cash involved has not been received or disbursed. The government-wide financial statements include two statements:

The *statement of net assets* presents information on all of the City of Somerville's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City of Somerville is improving or deteriorating. The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City of Somerville that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City of Somerville include general government, public safety, highways and streets, public works and cemetery, education, health and human services, employee benefits and capital, water and sewer, and culture and recreation.

Fund financial statements - A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Somerville, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City of Somerville can be divided into two categories: governmental funds and fiduciary funds.

Governmental funds - *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City of Somerville maintains fifteen individual governmental funds. Information is presented separately for the general fund, community development, and water and sewer in the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances. Data for certain governmental funds are combined into a single aggregated presentation under the caption *nonmajor governmental funds*.

The City of Somerville adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided as required supplementary information for the general fund to demonstrate compliance with this budget.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* all reflected in the government-wide financial statement because the resources of those funds are *not* available to support the City of Somerville's own programs. The accounting used for fiduciary funds records transactions using the flow of economic resources measurement focus and the accrual basis of accounting.

The fiduciary fund financial statements provide separate information for the pension trust fund of the City. All other fiduciary funds are combined into a single, aggregate presentation in the fiduciary fund financial statements under the caption private purpose trust funds.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City of Somerville’s budgetary basis of accounting. Required supplementary information can be found after the notes to the financial statements.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government’s financial position. In the case of the City of Somerville, Government-wide assets exceeded liabilities by \$143.9 million at the close of the most recent fiscal year. The schedule below highlights the major components.

Governmental Financial Highlights			
		FY 2005	FY 2004
Assets:			
	Current assets.....	\$ 77,143,509	\$ 69,759,117
	Noncurrent assets (excluding capital).....	34,163,553	36,168,235
	Capital assets.....	121,826,629	120,409,901
	Total assets.....	233,133,691	226,337,253
Liabilities:			
	Current liabilities (excluding debt).....	10,456,758	8,578,638
	Noncurrent liabilities (excluding debt).....	3,778,200	2,726,100
	Current debt.....	10,762,180	13,256,220
	Noncurrent debt.....	61,537,807	67,579,160
	Total liabilities.....	86,534,945	92,140,118
Net Assets:			
	Capital assets net of related debt.....	84,887,642	79,339,521
	Restricted.....	23,076,486	23,005,696
	Unrestricted.....	36,014,618	31,851,918
	Total net assets.....	\$ 143,978,746	\$ 134,197,135

The largest portion of the City of Somerville’s net assets (59 percent) reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment) less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to its citizens; consequently, these assets are *not* available for future spending. Although the City of Somerville’s investment in its capital assets is reported net of related debt, it should be noted that resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City of Somerville’s net assets (16 percent) represents resources that are subject to external restrictions on how they may be used. These include funds for street improvement (Ch 90), community development, Section 108 loans, expendable and nonexpendable funds and school grants.

The remaining balance of unrestricted net assets \$36.0 million (25 percent) may be used to meet the government’s ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City of Somerville is able to report positive balances in its three categories of net assets, both for the government as a whole and for its separate governmental activities.

Included within the noncurrent assets (excluding capital) is \$33.5 million in future year school construction reimbursement grants.

Long term liabilities include \$63.8 million in general obligation bonds and intergovernmental loans; \$2.1 million in compensated absence liabilities for unused vacation, special leave, and enhanced longevity benefits payable; and \$1.6 million in future year workers' compensation benefits payable.

Governmental activities. Governmental activities increased the City of Somerville's net assets by \$9.8 million (6.8 percent).

	FY 2005	FY 2004
Program revenues:		
Charges for services.....	\$ 34,490,112	\$ 27,731,615
Operating grants and contributions.....	54,784,342	57,131,888
Capital grants and contributions.....	-	1,075,394
General Revenues:		
Real estate and personal property taxes.....	73,459,378	69,354,408
Tax liens.....	19,413	190,730
Motor vehicle and other excise taxes.....	5,429,328	5,266,072
Penalties and interest on taxes.....	599,400	742,005
Payments in lieu of taxes.....	341,819	-
Nonrestricted grants and contributions.....	28,411,388	26,992,050
Unrestricted investment income.....	929,090	480,472
Gain on sale of capital assets.....	867,752	2,683,084
Premium on sale of bonds.....	-	76,854
Other revenues.....	177,997	357,549
Total revenues.....	199,510,019	192,082,121
Expenses:		
General government.....	8,844,823	7,912,746
Public safety.....	26,738,479	26,003,346
Education.....	60,414,022	61,176,994
Public works.....	18,016,263	15,802,869
Water & sewer.....	17,129,773	16,353,929
Intergovernmental subsidy.....	220,000	220,000
Community development.....	5,419,101	7,118,832
Human services.....	4,661	11,801
Culture and recreation.....	2,376,750	3,091,971
Pension benefits.....	18,907,078	17,048,989
Employee benefits.....	20,026,746	20,815,373
Interest.....	3,495,985	3,443,680
State and county charges.....	8,134,727	8,858,332
Total expenses.....	189,728,408	187,858,862
Change in net assets.....	\$ 9,781,611	\$ 4,223,259

Key elements of this increase are as follows:

- Collections of fees and building permits increased \$1.6 million, reflecting new development in the City
- Additional lottery money of \$950,000, the sale of capital assets totaling \$1.2 million and strong tax lien activity of \$1.1 million were other one-time monies received by the City in fiscal 2005.
- Property taxes increased by \$4.1 million (5.6 percent) during the year. Most of this increase is the product of a restricted tax levy that totaled \$74.7 million.
- Operating grants for governmental activities decreased by \$2.3 million, mostly as a result of a decrease in Community Development related grant proceeds.
- Capital grants decreased by \$1.1 million due to the decrease in spending related to reimbursable school construction costs from the MSBA.
- Nonrestricted grants and contributions increased by \$1.4 million, the result of an increase in state aid.

For the most part, expenses decreased in anticipation of revenue reductions. Noteworthy exceptions, however, were the City's costs for pensions and public works, which increased \$1.9 million (10.0%) and \$2.2 million (12.3%), respectively.

Financial Analysis of the Government's Funds

As noted earlier, the City of Somerville uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City of Somerville's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City of Somerville's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City of Somerville's governmental funds reported combined ending balances of \$36.1 million, an increase of \$5.4 million in comparison with the prior year. Approximately 39.1% of this total amount (\$15.1 million) constitutes *general fund unreserved fund balance*, which is available for spending at the government's discretion when certified as *free cash* by the Massachusetts Department of Revenue. Approximately 4.4% (\$1.6 million) of fund balance is also *unreserved* and reported in the special revenue, capital projects and permanent funds. The remainder is *reserved* to indicate that it is not available for new spending because it has already been 1) committed to liquidate prior period purchase orders and contracts, or pay ongoing capital articles (\$2.6 million) or 2) is restricted for expenditure by grants or other outside restrictions (\$16.8 million).

The general fund is the chief operating fund of the City of Somerville. At the end of the current fiscal year, unreserved fund balance of the general fund was \$15.1 million while the total fund balance reached \$23.1 million. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 10.1 percent of total general fund expenditures, while total fund balance represents 15.5 percent of that same amount.

The City's general fund increased \$7.9 million during the current fiscal year. Key factors in this growth were continued strong property tax revenues, an increase in fees and building permits of \$1.6 million, additional lottery money of \$950,000, the sale of capital assets totaling \$1.2 million and strong tax lien activity of \$1.1 million

General Fund Budgetary Highlights

The net change between the original budget and the final amended budget was an increase of \$228,457. However, there occurred numerous transfers and reversions of prior encumbrances that can be briefly summarized as follows:

- \$302 thousand decrease in general government
- \$334 thousand increase in public safety
- \$575 thousand increase in public works
- \$902 thousand decrease in employee benefits

Capital Asset and Debt Administration

Capital assets. The City of Somerville’s investment in capital assets for its governmental activities as of June 30, 2005, amounts to \$121.8 million (net of accumulated depreciation). This investment in capital assets includes land, buildings, system improvements, machinery and equipment, park facilities, roads, highways, and bridges. The net increase in the City’s investment in capital assets for the current year was \$5.4 million. Additional information on the City’s capital assets may be found in Note 4 to the financial statements.

	2005	2004
Land and land improvements.....	\$ 19,022,469	\$ 19,193,732
Construction in progress.....	1,102,642	182,690
Books and periodicals.....	828,668	838,444
Buildings and improvements.....	81,099,715	84,179,936
Machinery and equipment.....	1,600,407	1,022,741
Vehicles.....	1,769,392	1,628,074
Infrastructure.....	<u>16,403,336</u>	<u>13,364,284</u>
 Total.....	 <u>\$ 121,826,629</u>	 <u>\$ 120,409,901</u>

Major capital asset events during the current fiscal year included the following:

- Various system improvements were completed by the Water and Sewer Departments;
- A variety of equipment was purchased by City Departments;
- Various park projects are underway throughout the City;

In conjunction with the operating budget, the City annually prepares a capital budget for the upcoming fiscal year and a five-year Capital Improvement Plan (CIP) that is used as a guide for future capital expenditures.

Long-term debt. At the end of the current fiscal year, the City of Somerville had total bonded debt outstanding of \$68.8 million. Additionally, short-term borrowing is at \$6.2 million and is due to various school projects, building renovations and sewer projects.

City of Somerville's General Obligation Bonds Outstanding

	2005	2004
Municipal Purpose November 15, 1995.....	\$ -	\$ 690,000
Municipal Purpose April 1, 1998.....	13,905,000	14,830,000
Municipal Purpose February 15, 1997.....	14,105,000	15,020,000
Water Projects - July 1, 1996.....	110,000	220,000
Sewer Projects - July 1, 1996.....	115,000	230,000
MWRA Notes.....	4,022,987	3,223,380
Municipal Purpose February 15, 2002.....	23,650,000	24,795,000
General Obligation Bond March 15,2004.....	10,230,000	10,355,000
 Total bonds and notes payable.....	 66,137,987	 69,363,380
 Sections 108 Intergovernmental Loans.....	 2,620,000	 2,900,000
 Total.....	 \$ 68,757,987	 \$ 72,263,380

The City's long-term debt decreased by \$3.5 million during the fiscal year. The key factor in this decrease is the net effect of the pay down of debt and the issuance of \$1.7million in MWRA bonds.

Moody's Investors Service, Inc. and Standard and Poors Corporation have assigned ratings of Aaa and AAA to the City's bonds.

Economic Factors and Next Year's Budgets and Rates

- According to the U.S. Census Bureau, the median family income for the City in 2000 was \$51,243 compared with \$61,644 for the Commonwealth and \$49,600 for the nation. The per capita income was \$23,628, compared with \$25,952 for the Commonwealth and \$21,690 for the nation
- The unemployment rate for the City of Somerville is approximately 3.2 percent, which is a .3% increase from a rate of 2.9 percent a year ago. This compares favorably to the state's average unemployment rate of 4.9 percent and the national average of 4.9 percent.
- According to the City's Board of Assessors, the average 2005 single family home in the City is valued at \$412,400; the average two-family home is valued at \$507,400; the average 2005 commercial and industrial property is valued at \$1,093,700 – all compare favorably with state and national property values.

These factors were considered in preparing the City of Somerville's budget for the 2005 fiscal year.

The Mayor and Board of Aldermen have approved a fiscal year 2006 general fund operating budget of \$145,637,220. In addition, \$2,577,373 in appropriations and encumbrances were brought forward from the fiscal year ended June 30, 2005, for a total general fund operating budget of \$148,214,593. This represents a \$9,878,369 increase over the final fiscal year 2005 general fund operating budget.

The total property tax levy for fiscal 2006 was approved at \$78,525,814 a increase of \$3,792,236 million from fiscal 2005.

Requests for Information

This financial report is designed to provide a general overview of the City of Somerville's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, City Hall, 93 Highland Ave, Somerville, Massachusetts 01960.

Basic Financial Statements

STATEMENT OF NET ASSETS

JUNE 30, 2005

	Primary Government
	Governmental Activities
ASSETS	
CURRENT:	
Cash and short-term investments.....	\$ 41,675,819
Receivables, net of allowance for uncollectibles:	
Real estate and personal property taxes.....	1,375,912
Tax liens and foreclosures.....	1,022,553
Motor vehicle excise tax.....	590,030
User fees.....	7,969,905
Departmental and other.....	1,536,255
Intergovernmental.....	14,481,348
Loans.....	8,368,615
Other assets.....	6,390
Deferred charges on refunding.....	116,682
NONCURRENT:	
Receivables, net of allowance for uncollectibles:	
Intergovernmental.....	33,543,000
Deferred charges on refunding.....	620,553
Capital assets, net of accumulated depreciation.....	121,826,629
TOTAL ASSETS.....	233,133,691
LIABILITIES	
CURRENT:	
Warrants payable.....	4,511,909
Accrued liabilities.....	258,331
Accrued payroll.....	1,240,346
Health claims payable.....	1,679,000
Tax refunds payable.....	495,000
Accrued interest.....	1,123,992
Abandoned property.....	728,380
Compensated absences.....	238,700
Workers' compensation.....	181,100
Intergovernmental loans payable.....	280,000
Bonds and notes payable.....	10,762,180
NONCURRENT:	
Compensated absences.....	2,148,300
Workers' compensation.....	1,629,900
Intergovernmental loans payable.....	2,340,000
Bonds and notes payable.....	61,537,807
TOTAL LIABILITIES.....	89,154,945
NET ASSETS	
Invested in capital assets, net of related debt.....	84,887,642
Restricted for:	
Streets.....	2,591,803
Community development.....	8,957,242
Loans.....	8,368,615
Permanent funds:	
Expendable.....	165,688
Nonexpendable.....	433,126
Other specific purposes.....	2,560,012
Unrestricted.....	36,014,618
TOTAL NET ASSETS.....	\$ 143,978,746

See notes to basic financial statements.

STATEMENT OF ACTIVITIES

FISCAL YEAR ENDED JUNE 30, 2005

Functions/Programs	Program Revenues			Net (Expense) Revenue
	Expenses	Charges for Services	Operating Grants and Contributions	
Primary Government:				
<i>Governmental Activities:</i>				
General government.....	\$ 8,844,823	\$ 1,929,777	\$ 1,183,820	\$ (5,731,226)
Public safety.....	26,738,479	9,394,324	2,233,643	(15,110,512)
Education.....	60,414,022	2,424,782	32,845,893	(25,143,347)
Public works.....	18,016,263	411,976	1,789,910	(15,814,377)
Water & sewer.....	17,129,773	19,870,735	-	2,740,962
Intergovernmental subsidy.....	220,000	-	-	(220,000)
Community development.....	5,419,101	100	5,390,842	(28,159)
Human services.....	4,661	173,966	110,185	279,490
Culture and recreation.....	2,376,750	284,452	205,639	(1,886,659)
Pension benefits.....	18,907,078	-	9,072,034	(9,835,044)
Employee benefits.....	20,026,746	-	-	(20,026,746)
Interest.....	3,495,985	-	1,952,376	(1,543,609)
State and county charges.....	8,134,727	-	-	(8,134,727)
Total Primary Government.....	\$ 189,728,408	\$ 34,490,112	\$ 54,784,342	\$ (100,453,954)

See notes to basic financial statements.

(Continued)

STATEMENT OF ACTIVITIES (Continued)

FISCAL YEAR ENDED JUNE 30, 2005

	<i>Primary Government</i>
	<u>Governmental Activities</u>
Changes in net assets:	
Net (expense) revenue from previous page.....	\$ (100,453,954)
<i>General revenues:</i>	
Real estate and personal property taxes, net of tax refunds payable.....	73,459,378
Tax liens.....	19,413
Motor vehicle and other excise taxes.....	5,429,328
Penalties and interest on taxes.....	599,400
Payments in lieu of taxes.....	341,819
Grants and contributions not restricted to specific programs.....	28,411,388
Unrestricted investment income.....	929,090
Gain on sale of capital assets.....	867,752
Miscellaneous.....	177,997
Total general revenues and transfers.....	<u>110,235,565</u>
Change in net assets.....	9,781,611
<i>Net Assets:</i>	
Beginning of year.....	<u>134,197,135</u>
End of year.....	\$ <u><u>143,978,746</u></u>

(Concluded)

**GOVERNMENTAL FUNDS
BALANCE SHEET**

JUNE 30, 2005

ASSETS	General	Community Development	Water & Sewer	Nonmajor Governmental Funds	Total Governmental Funds
Cash and short-term investments.....	\$ 29,354,315	\$ 94,795	\$ -	\$ 12,226,709	\$ 41,675,819
Receivables, net of uncollectibles:					
Real estate and personal property taxes.....	1,375,912	-	-	-	1,375,912
Tax liens and foreclosures.....	1,022,553	-	-	-	1,022,553
Motor vehicle excise taxes.....	590,030	-	-	-	590,030
User fees.....	2,347,903	-	5,622,002	-	7,969,905
Departmental and other.....	1,536,255	-	-	-	1,536,255
Intergovernmental.....	35,361,000	9,302,989	-	3,360,359	48,024,348
Loans.....	-	8,368,615	-	-	8,368,615
Due from other funds.....	639,281	-	-	-	639,281
Other assets.....	6,390	-	-	-	6,390
TOTAL ASSETS.....	\$ 72,233,639	\$ 17,766,399	\$ 5,622,002	\$ 15,587,068	\$ 111,209,108
LIABILITIES AND FUND BALANCES					
LIABILITIES:					
Warrants payable.....	\$ 2,761,647	\$ 345,817	\$ 305,713	\$ 1,098,732	\$ 4,511,909
Accrued liabilities.....	258,331	-	-	-	258,331
Accrued payroll.....	967,119	-	-	273,227	1,240,346
Health claims payable.....	1,679,000	-	-	-	1,679,000
Tax refunds payable.....	495,000	-	-	-	495,000
Accrued interest on short-term debt.....	145,778	-	-	-	145,778
Abandoned property.....	728,380	-	-	-	728,380
Deferred revenues.....	42,098,213	8,957,242	5,622,002	2,591,803	59,269,260
Due to other funds.....	-	-	639,281	-	639,281
Notes payable.....	-	-	-	6,162,000	6,162,000
TOTAL LIABILITIES.....	49,133,468	9,303,059	6,566,996	10,125,762	75,129,285
FUND BALANCES:					
Reserved for:					
Encumbrances and continuing appropriations.....	2,577,373	-	-	-	2,577,373
Loans.....	-	8,368,615	-	-	8,368,615
Employee benefits.....	5,480,973	-	-	-	5,480,973
Perpetual permanent funds.....	-	-	-	433,126	433,126
Other specific purposes.....	-	-	-	2,560,012	2,560,012
Unreserved:					
Designated for subsequent year's expenditures.....	3,275,000	-	-	-	3,275,000
Designated for affordable housing.....	416,121	-	-	-	416,121
Undesignated, reported in:					
General fund.....	11,350,704	-	-	-	11,350,704
Special revenue funds.....	-	94,725	(944,994)	5,179,653	4,329,384
Capital projects funds.....	-	-	-	(2,877,173)	(2,877,173)
Permanent funds.....	-	-	-	165,688	165,688
TOTAL FUND BALANCES.....	23,100,171	8,463,340	(944,994)	5,461,306	36,079,823
TOTAL LIABILITIES AND FUND BALANCES.....	\$ 72,233,639	\$ 17,766,399	\$ 5,622,002	\$ 15,587,068	\$ 111,209,108

See notes to basic financial statements.

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TOTAL FUND BALANCES TO THE STATEMENT OF NET ASSETS**

FISCAL YEAR ENDED JUNE 30, 2005

Total governmental fund balances.....		\$ 36,079,823
Capital assets (net) used in governmental activities are not financial resources and, therefore, are not reported in the funds.....		121,826,629
Accounts receivable are not available to pay for current-period expenditures and, therefore, are deferred in the funds.....		59,269,260
In the statement of activities, interest is accrued on outstanding long-term debt, whereas in governmental funds interest is not reported until due.....		(978,214)
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the governmental funds:		
Bonds and notes payable.....	(68,757,987)	
Workers compensation.....	(1,811,000)	
Compensated absences.....	(2,387,000)	
Net effect of reporting long-term liabilities.....		(72,955,987)
In the statement of activities, deferred losses are reported for refundings of debt, which are amortized over the shorter of the remaining life of the refunding bonds or refunded bonds. In governmental funds, defeasances of debt are expensed when the refunding bonds are issued.....		737,235
Net assets of governmental activities.....		\$ 143,978,746

See notes to basic financial statements.

GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

FISCAL YEAR ENDED JUNE 30, 2005

	General	Community Development	Water & Sewer	Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:					
Real estate and personal property taxes, net of tax refunds.....	\$ 72,598,949	\$ -	\$ -	\$ -	\$ 72,598,949
Tax liens.....	1,144,242	-	-	-	1,144,242
Motor vehicle and other excise taxes.....	5,379,484	-	-	-	5,379,484
Water and sewer charges.....	-	-	17,459,055	-	17,459,055
Payments in lieu of taxes.....	341,819	-	-	-	341,819
Intergovernmental.....	61,586,312	5,336,946	-	14,983,134	81,906,392
Departmental and other.....	12,689,429	10,000	-	5,552,678	18,252,107
Investment income (loss).....	613,010	22,820	25,366	267,894	929,090
TOTAL REVENUES.....	154,353,245	5,369,766	17,484,421	20,803,706	198,011,138
EXPENDITURES:					
Current:					
General government.....	7,552,483	-	-	1,211,741	8,764,224
Public safety.....	24,682,560	-	-	1,680,164	26,362,724
Education.....	43,823,443	-	-	14,509,168	58,332,611
Public works.....	16,331,956	-	-	4,560,390	20,892,346
Water and sewer.....	-	-	17,129,773	-	17,129,773
Intergovernmental subsidy.....	-	220,000	-	-	220,000
Community development.....	-	5,436,101	-	-	5,436,101
Human services.....	-	-	-	3,849	3,849
Culture and recreation.....	2,199,110	-	-	437,781	2,636,891
Pension benefits.....	18,907,078	-	-	-	18,907,078
Employee benefits.....	20,026,746	-	-	-	20,026,746
State and county charges.....	8,134,727	-	-	-	8,134,727
Debt service:					
Principal.....	3,703,421	280,000	700,800	-	4,684,221
Interest.....	3,160,091	132,994	181,240	-	3,474,325
TOTAL EXPENDITURES.....	148,521,615	6,069,095	18,011,813	22,403,093	195,005,616
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES.....	5,831,630	(699,329)	(527,392)	(1,599,387)	3,005,522
OTHER FINANCING SOURCES (USES):					
Proceeds from bonds and notes.....	-	-	-	1,178,828	1,178,828
Sale of capital assets.....	1,234,671	-	-	-	1,234,671
Operating transfers in.....	924,277	-	-	-	924,277
Operating transfers out.....	-	-	-	(924,277)	(924,277)
TOTAL OTHER FINANCING SOURCES (USES).....	2,158,948	-	-	254,551	2,413,499
NET CHANGE IN FUND BALANCES.....	7,990,578	(699,329)	(527,392)	(1,344,836)	5,419,021
FUND BALANCES AT BEGINNING OF YEAR.....	15,109,593	9,162,669	(417,602)	6,806,142	30,660,802
FUND BALANCES AT END OF YEAR.....	\$ 23,100,171	\$ 8,463,340	\$ (944,994)	\$ 5,461,306	\$ 36,079,823

See notes to basic financial statements.

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES**

FISCAL YEAR ENDED JUNE 30, 2005

Net change in fund balances - total governmental funds.....	\$	5,419,021
<p>Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.</p>		
Capital outlay.....		7,109,180
Depreciation expense.....		<u>(5,325,533)</u>
Net effect of reporting capital assets.....		1,783,647
<p>In the Statement of Activities, only the <i>gain</i> on the sale of capital assets is reported, whereas in the governmental funds the entire proceeds of the sale are reported as financial resources. As a result, the change in net assets differs from the change in fund balance by the cost of the capital assets sold.....</p>		
		(366,919)
<p>Revenues in the Statement of Activities that do not provide current financial resources are fully deferred in the Statement of Revenues, Expenditures and Changes in Fund Balances. Therefore, the recognition of revenue for various types of accounts receivable (i.e., real estate and personal property, motor vehicle excise, etc.) differ between the two statements. This amount represents the net change in deferred revenue.....</p>		
		631,129
<p>The issuance of long-term debt (e.g., bonds and leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities.</p>		
Proceeds from bonds and notes.....		(1,178,828)
Debt service principal payments.....		4,684,221
Amortization of deferred charge on refunding.....		<u>(137,297)</u>
Net effect of reporting long-term debt.....		3,368,096
<p>Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds.</p>		
Net change in compensated absences accrual.....		213,000
Net change in accrued interest on long-term debt.....		115,637
Net change in workers' compensation accrual.....		<u>(1,382,000)</u>
Net effect of recording long-term liabilities and amortizing deferred losses.....		<u>(1,053,363)</u>
Change in net assets of governmental activities.....	\$	<u>9,781,611</u>

See notes to basic financial statements.

FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS

JUNE 30, 2005

	Pension Trust Fund (as of December 31, 2004)	Private Purpose Trust Funds	Agency Funds
ASSETS			
CURRENT:			
Cash and short-term investments.....	\$ 7,719,694	\$ 94,070	\$ 384,132
Investments.....	143,906,138	-	-
Interest and dividends.....	101,008	-	-
Receivables, net of allowance for uncollectibles:			
Intergovernmental.....	750,844	-	-
TOTAL ASSETS	152,477,684	94,070	384,132
LIABILITIES			
Liabilities due depositors.....	-	-	384,132
NET ASSETS			
Held in trust for pension benefits and other purposes.....	\$ <u>152,477,684</u>	\$ <u>94,070</u>	\$ <u>-</u>

See notes to basic financial statements.

FIDUCIARY FUNDS
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

FISCAL YEAR ENDED JUNE 30, 2005

	Pension Trust Fund (as of December 31, 2004)	Private Purpose Trust Funds
ADDITIONS:		
Contributions:		
Employer.....	\$ 10,336,779	\$ -
Employee.....	3,992,984	-
Private donations.....	-	4,426
Total contributions.....	14,329,763	4,426
Net investment income (loss):		
Net change in fair value of investments.....	13,742,460	-
Interest.....	5,368,866	1,643
Total investment income (loss).....	19,111,326	1,643
Less: investment expense.....	(950,235)	-
Net investment income (loss).....	18,161,091	1,643
Intergovernmental.....	915,301	-
Transfers from other systems.....	1,049,921	-
TOTAL ADDITIONS.....	34,456,076	6,069
DEDUCTIONS:		
Administration.....	287,967	-
Transfers to other systems.....	1,105,699	-
Retirement benefits and refunds.....	18,073,954	-
Educational scholarships.....	-	5,250
TOTAL DEDUCTIONS.....	19,467,620	5,250
CHANGE IN NET ASSETS.....	14,988,456	819
NET ASSETS AT BEGINNING OF YEAR.....	137,489,228	93,251
NET ASSETS AT END OF YEAR.....	\$ 152,477,684	\$ 94,070

See notes to basic financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying basic financial statements of the City of Somerville, Massachusetts (the City) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The significant City accounting policies are described herein.

A. Reporting Entity

The City is a municipal corporation that is governed by an elected Mayor and an eleven member Board of Alderman (Board).

For financial reporting purposes, the City has included all funds, organizations, account groups, agencies, boards, commissions and institutions. The City has also considered all potential component units for which it is financially accountable as well as other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the basic financial statements to be misleading or incomplete. As required by GAAP, these basic financial statements present the City (primary government) and its component units. One entity has been included as a component unit in the reporting entity, because of the significance of its operational and/or financial relationship.

Blended Component Units – Blended component units are entities that are legally separate from the City, but are so related that they are, in substance, the same as the City or entities providing services entirely or almost entirely for the benefit of the City. The following component unit is blended within the primary government:

In the Fiduciary Funds:

The Somerville Contributory Retirement System (System) was established to provide retirement benefits to City employees, the City Housing Authority employees, and their beneficiaries. The System is governed by a five-member board comprised of the City Auditor (ex-officio), two members elected by the System's participants, one member appointed by the Mayor and one member appointed by the Board members. The System is presented using the accrual basis of accounting and is reported as a pension trust fund in the fiduciary fund financial statements.

Availability of Financial Information for Component Units

The System did not issue a separate audited financial statement. The System issues a publicly available unaudited financial report in accordance with guidelines established by the Commonwealth of Massachusetts' (Commonwealth) Public Employee Retirement Administration Commission (PERAC). That report may be obtained by contacting the System located at 50 Evergreen Avenue, Somerville, Massachusetts 02145.

B. Government-Wide and Fund Financial Statements***Government-Wide Financial Statements***

The government-wide financial statements (i.e., statement of net assets and the statement of changes in net assets) report information on all of the non-fiduciary activities of the primary government and its component units. *Governmental activities* are primarily supported by taxes and intergovernmental revenues.

Fund Financial Statements

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though fiduciary funds are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements. Non-major funds are aggregated and displayed in a single column.

Major Fund Criteria

Major funds must be reported if the following criteria are met:

- If the total assets, liabilities, revenues, or expenditures/expenses of an individual governmental fund are at least 10 percent of the corresponding element (assets, liabilities, etc.) for all funds of that category or type (total governmental funds), *and*
- If the total assets, liabilities, revenues, or expenditures/expenses of the individual governmental funds are at least 5 percent of the corresponding element for all governmental funds combined.

Additionally, any other governmental fund that management believes is particularly significant to the basic financial statements may be reported as a major fund.

Internal service funds and fiduciary funds are reported by fund type.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation*Government-Wide Financial Statements*

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when the liabilities are incurred. Real estate and personal property taxes are recognized as revenues in the fiscal year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The statement of activities demonstrates the degree to which the direct expenses of a particular function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include the following:

- Charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment.
- Grants and contributions that are restricted to meeting the operational requirements of a particular function or segment.
- Grants and contributions that are restricted to meeting the capital requirements of a particular function or segment.

Taxes and other items not identifiable as program revenues are reported as general revenues.

For the most part, the effect of interfund activity has been removed from the government-wide financial statements.

Fund Financial Statements

Governmental fund financial statements are reported using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., measurable and available). Measurable means the amount of the transaction can be determined and available means collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on general long-term debt which is recognized when due, and certain compensated absences and claims and judgments which are recognized when the obligations are expected to be liquidated with current expendable available resources.

Real estate and personal property tax revenues are considered available if they are collected within 60 days after fiscal year-end. Investment income is susceptible to accrual. Other receipts and tax revenues become measurable and available when the cash is received and are recognized as revenue at that time.

Entitlements and shared revenues are recorded at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditure driven grants recognize revenue when the qualifying expenditures are incurred and all other grant requirements are met.

The following major governmental funds are reported:

The *general fund* is the primary operating fund. It is used to account for all financial resources, except those that are required to be accounted for in another fund.

The *community development fund* is used to account for activities of the Office of Housing and Community Development.

The *water & sewer fund* is used to account for financial resources related to the City's water & sewer activities.

The nonmajor governmental funds consist of other special revenue, capital projects and permanent funds that are aggregated and presented in the *nonmajor governmental funds* column on the governmental funds financial statements. The following describes the general use of these fund types:

The *special revenue fund* is used to account for the proceeds of specific revenue sources (other than permanent funds or capital projects funds) that are restricted by law or administrative action to expenditures for specified purposes.

The *capital projects fund* is used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by Trust Funds).

The *permanent fund* is used to account for financial resources that are legally restricted to the extent that only earnings, not principal, may be used for purposes that support the governmental programs.

Fiduciary fund financial statements are reported using the flow of economic resources measurement focus and use the accrual basis of accounting. Fiduciary funds are used to account for assets held in a trustee capacity for others that cannot be used to support the governmental programs.

The following fiduciary fund types are reported:

The *pension trust fund* is used to account for the activities of the System, which accumulates resources to provide pension benefits to eligible retirees and their beneficiaries.

The *private-purpose trust fund* is used to account for trust arrangements, other than those properly reported in the pension trust fund or permanent fund, under which principal and investment income exclusively benefit individuals, private organizations, or other governments.

The *agency fund* is used to account for assets held in a purely custodial capacity.

Government-Wide and Fund Financial Statements

For the government-wide financial statements, and proprietary and fiduciary fund accounting, all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or prior to November 30, 1989, are applied, unless those pronouncements conflict with or contradict GASB pronouncements.

D. Cash and Investments

Government-Wide and Fund Financial Statements

Cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with an original maturity of three months or less from the date of acquisition. Investments are carried at fair value.

E. Accounts Receivable

Government-Wide and Fund Financial Statements

The recognition of revenue related to accounts receivable reported in the government-wide financial statements and the fiduciary funds financial statements are reported under the accrual basis of accounting. The recognition of revenue related to accounts receivable reported in the governmental funds financial statements are reported under the modified accrual basis of accounting.

Real Estate, Personal Property Taxes and Tax Liens

Real estate and personal property taxes are levied and based on values assessed on January 1st of every year. Assessed values are established by the Board of Assessor's for 100% of the estimated fair market value. Taxes are due on August 1st, November 1st, February 1st and May 1st and are subject to penalties and interest if they are not paid by the respective due date. Real estate and personal property taxes levied are recorded as receivables in the fiscal year of the levy.

Real estate tax liens are processed six months after the close of the valuation year on delinquent properties and are recorded as receivables in the fiscal year they are processed.

Real estate receivables are secured via the tax lien process and are considered 100% collectible. Accordingly, an allowance for uncollectibles is not reported.

Personal property taxes cannot be secured through the lien process. The allowance of uncollectibles is estimated based on historical trends and specific account analysis.

Motor Vehicle Excise

Motor vehicle excise taxes are assessed annually for each vehicle registered in the City and are recorded as receivables in the fiscal year of the levy. The Commonwealth is responsible for reporting the number of vehicles registered and the fair values of those vehicles. The tax calculation is the fair value of the vehicle multiplied by \$25 per \$1,000 of value. The allowance for uncollectibles is estimated based on historical trends and specific account analysis.

Water and Sewer

User fees are levied monthly based on individual meter readings and are subject to penalties and interest if they are not paid by the respective due date. Water and Sewer liens are processed in December of every year and included as a lien on the property owner's tax bill. Water and Sewer charges and liens are recorded as receivables in the fiscal year of the levy.

Since the receivables are secured via the lien process, these accounts are considered 100% collectible and therefore do not report an allowance for uncollectibles.

Departmental and Other

Departmental and other receivables consist primarily of parking fines and are recorded as receivables in the fiscal year accrued. The allowance of uncollectibles is estimated based on historical trends and specific account analysis.

Intergovernmental

Various federal and state grants for operating and capital purposes are applied for and received annually. For non-expenditure driven grants, receivables are recorded as soon as all eligibility requirements imposed by the provider have been met. For expenditure driven grants, receivables are recorded when the qualifying expenditures are incurred and all other grant requirements are met.

These receivables are considered 100% collectible and therefore do not report an allowance for uncollectibles.

Loans

The Department of Planning and Development administers loan programs that provide housing assistance to residents and capital needs assistance for small businesses. Upon issuance, a receivable is recorded for the principal amount of the loan.

Loan receivables are secured via the lien process and are considered 100% collectible. Accordingly, an allowance for uncollectibles is not reported.

F. Inventories***Government-Wide and Fund Financial Statements***

Inventories are recorded as expenditures at the time of purchase. Such inventories are not material in total to the government-wide and fund financial statements, and therefore are not reported.

G. Capital Assets

Government-Wide Fund Financial Statements

Capital assets, which include land, construction in progress, land improvements, buildings, machinery and equipment, vehicles, and infrastructure (e.g., roads, water mains, sewer mains, and similar items), are reported in the applicable governmental activity column of the government-wide financial statements. Capital assets are recorded at historical cost, or at estimated historical cost, if actual historical cost is not available. Donated capital assets are recorded at the estimated fair market value at the date of donation. Construction period interest is capitalized on constructed capital assets except for the capital assets of the governmental activities column in the government-wide financial statements.

All purchases and construction costs in excess of \$10,000 are capitalized at the date of acquisition or construction, respectively, with expected useful lives of greater than one year.

Capital assets (excluding land) are depreciated on a straight-line basis. The estimated useful lives of capital assets are as follows:

<u>Capital Asset Type</u>	<u>Estimated Useful Life (in years)</u>
Land improvements.....	20-40
Buildings and improvements.....	20-40
Machinery and equipment.....	5-10
Vehicles.....	5-15
Infrastructure.....	10-50

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized and are treated as expenses when incurred. Improvements are capitalized.

Governmental Fund Financial Statements

Capital asset costs are recorded as expenditures in the acquiring fund in the fiscal year of the purchase.

H. Interfund Receivables and Payables

During the course of its operations, transactions occur between and within individual funds that may result in amounts owed between funds.

Government-Wide Financial Statements

Transactions of a buyer/seller nature between and within governmental funds and internal service funds are eliminated from the governmental activities in the statement of net assets. Any residual balances outstanding between the governmental activities and business-type activities are reported in the statement of net assets as "internal balances".

Fund Financial Statements

Transactions of a buyer/seller nature between and within funds are *not* eliminated from the individual fund statements. Receivables and payables resulting from these transactions are classified as “Due from other funds” or “Due to other funds” on the balance sheet.

I. Interfund Transfers

During the course of its operations, resources are permanently reallocated between and within funds. These transactions are reported as operating transfers in and operating transfers out.

Government-Wide Financial Statements

Operating transfers between and within governmental funds are eliminated from the governmental activities in the statement of activities. Any residual balances outstanding between the governmental activities are reported in the statement of activities as “Transfers, net”.

Fund Financial Statements

Operating transfers between and within funds are *not* eliminated from the individual fund statements and are reported as operating transfers in and operating transfers out.

J. Deferred Revenue

Deferred revenue at the governmental fund financial statement level represents billed receivables that do not meet the available criterion in accordance with the current financial resources measurement focus and the modified accrual basis of accounting. Deferred revenue is recognized as revenue in the conversion to the government-wide (full accrual) financial statements.

K. Net Assets and Fund Equity*Government-Wide Financial Statements (Net Assets)*

Net assets are reported as restricted when amounts that are not available for appropriation or are legally restricted by outside parties for a specific future use.

Net assets have been “restricted for” the following:

“Streets” represents amounts committed by the Commonwealth for the repair and/or construction of streets.

“Community Development” represents amounts committed by the federal Department of Housing and Urban Development (HUD) for various community development projects.

“Loans” represents community development outstanding loans receivable balances.

“Permanent funds - expendable” represents amounts held in trust for which the expenditures are restricted by various trust agreements.

“Permanent funds - nonexpendable” represents amounts held in trust for which only investment earnings may be expended.

“Other specific purposes” represents restrictions placed on assets from outside parties.

Fund Financial Statements (Fund Balances)

Fund balances are reserved for amounts that are not available for appropriation or are legally restricted by outside parties for a specific future use. Designations of fund balance represent tentative management plans that are subject to change.

Fund balances have been “reserved for” the following:

“Encumbrances and continuing appropriations” represents amounts obligated under purchase orders, contracts and other commitments for expenditures that are being carried over to the ensuing fiscal year.

“Loans” represents community development outstanding loans receivable balances.

“Employee benefits” represents the amount accumulated for the specific purpose of providing health insurance coverage for the City’s employees and retirees.

“Perpetual permanent funds” represents amounts held in trust for which only investment earnings may be expended.

“Other specific purposes” represents restrictions placed on assets from outside parties.

Fund balances have been “designated for” the following:

“Subsequent year’s expenditures” represents amounts appropriated for the fiscal year 2006 operating budget.

“Affordable Housing” represents funds set aside for the preservation and creation of affordable homes and rental units within the City.

L. Long-term debt

Government-Wide and Proprietary Fund Financial Statements

Long-term debt is reported as a liability in the government-wide statement of net assets. Material bond premiums and discounts are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

Governmental Fund Financial Statements

The face amount of governmental funds long-term debt is reported as other financing sources. Bond premiums and discounts, as well as issuance costs, are recognized in the current period. Bond premiums are reported as other financing sources and bond discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual bond proceeds received, are reported as general government expenditures.

M. Investment Income

Excluding the permanent funds, investment income derived from major and nonmajor governmental funds is legally assigned to the general fund unless otherwise directed by Massachusetts General Law (MGL).

N. Compensated Absences

Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements, state laws and executive policies.

Government-Wide Financial Statements

Vested or accumulated vacation and sick leave are reported as liabilities and expensed as incurred.

Governmental Fund Financial Statements

Vested or accumulated vacation and sick leave, which will be liquidated with expendable available financial resources, are reported as expenditures and fund liabilities.

O. Post Retirement Benefits

Government-Wide and Fund Financial Statements

In addition to providing pension benefits, health insurance coverage is provided for retired employees and their survivors in accordance with MGL, Chapter 32, on a pay-as-you-go basis. The cost of providing health insurance is recognized by recording the employer's 90% share of insurance premiums in the general fund in the fiscal year paid. For the fiscal year ended June 30, 2005, this expense/expenditure totaled approximately \$8,526,000. There were 1270 participants eligible to receive benefits at June 30, 2005.

P. Use of Estimates

Government-Wide and Fund Financial Statements

The preparation of basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure for contingent assets and liabilities at the date of the basic financial statements and the reported amounts of the revenues and expenditures/expenses during the fiscal year. Actual results could vary from estimates that were used.

Q. Individual Fund Deficits

At June 30, 2005, a fund deficit exists within the Water and Sewer Fund. This deficit will be funded through user charges and available funds.

R. Total Column

Government-Wide Financial Statements

The total column presented on the government-wide financial statements represents consolidated financial information.

Fund Financial Statements

The total column on the fund financial statements is presented only to facilitate financial analysis. Data in this column is not the equivalent of consolidated financial information.

NOTE 2 - CASH AND INVESTMENTS

A cash and investment pool is maintained that is available for use by all funds. Each fund type's portion of this pool is displayed on the combined balance sheet as "Cash and Short-term Investments". The deposits and investments of the trust funds are held separately from those of other funds.

Statutes authorize the investment in obligations of the U.S. Treasury, agencies, and instrumentalities, certificates of deposit, repurchase agreements, money market accounts, bank deposits and the State Treasurer's Investment Pool (the Pool). In addition, there are various restrictions limiting the amount and length of deposits and investments.

The Pool meets the criteria of an external investment pool. The Pool is administered by the Massachusetts Municipal Depository Trust (MMDT), which was established by the Treasurer of the Commonwealth who serves as Trustee. The fair value of the position in the Pool is the same as the value of the Pool shares.

Custodial Credit Risk – Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the City of Somerville's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At fiscal year-end, the carrying amount of deposits totaled \$34,503,427 and the bank balance totaled \$35,498,743. Of the bank balance, \$400,000 was covered by Federal Depository Insurance, no deposits were covered by the Depositors Insurance Fund or by the Share Insurance Fund, and \$35,098,743 was exposed to custodial credit risk because it was uninsured and uncollateralized.

At December 31, 2004, carrying amount of deposits for the System totaled \$6,193,516 and the bank balance totaled \$6,527,135. Of the bank balance, \$270,614 was covered by Federal Depository Insurance, no deposits were covered by the Depositors Insurance Fund or by the Share Insurance Fund, and \$7,782,699 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Investments

As of June 30, 2005, the City of Somerville had the following investments:

<u>Other Investments</u>	
MMDT.....	\$ <u>7,650,594</u>

As of December 31, 2004, the System had the following investments:

Investment Type	Maturity				
	Fair Value	Under 1 Year	1-5 Years	6-10 Years	Over 10 Years
Debt Securities					
U.S. Government Agencies.....	\$ 2,421,673	\$ -	\$ 795,974	\$ 1,211,774	\$ 413,925
Corporate Bonds.....	6,038,244	-	2,308,657	1,578,526	2,151,061
Fixed Income Mutual Fund *.....	30,625,611	-	-	-	30,625,611
Federal Home Loan Mortgage.....	401,514	-	168,558	-	232,956
Federal National Mortgage Association.....	840,315	-	268,725	-	571,590
State of Israel Bond.....	250,000	250,000	-	-	-
Total Debt Securities.....	40,577,357	\$ 250,000	\$ 3,541,914	\$ 2,790,300	\$ 33,995,143
Other Investments					
Equity Securities.....	\$ 80,695,902				
Equity Securities (International).....	7,426,040				
Real Estate.....	15,206,839				
Money Market Mutual Funds.....	1,526,178				
Total Investments.....	\$ 145,432,316				

* At Decemeber 31, 2004, the Fixed Income Mutual Fund had an average effective maturity of 11.12 years.

Custodial Credit Risk – Investments

For an investment, this is the risk that, in the event of a failure by the counterparty, the City will not be able to recover the value of its investments or collateral security that are in the possession of an outside party. The City does not have custodial credit risk exposure because the City’s investment of \$7,650,594 is invested with MMDT. The City does not have a formal investment policy for custodial credit risk.

Of the System’s investments of \$2,421,673 in U.S. Government Securities, \$6,038,244 in Corporate Bonds, \$401,514 in Federal Home Loan Mortgage, \$840,315 in Federal National Mortgage Association, \$88,121,942 in Domestic and International Equity Securities, and \$1,526,178 in Real Estate Investments, the System has custodial credit risk exposure of \$99,349,866 because the related securities are uninsured, unregistered and held by the counterparty. The System has not adopted a formal investment policy for custodial credit risk.

Interest Rate Risk

Neither the City or the System, have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

The City has not adopted a formal policy related to Credit Risk. The City does not have any debt securities as of June 30, 2005.

The System has not adopted a formal policy related to Credit Risk. The System's security ratings as of December 31, 2004 are as follows:

Debt Securities

Quality Ratings	U.S. Government Agencies	Corporate Bonds	Fixed Income Mutual Fund *	Federal Home Loan Mortgage	Federal National Mortgage Association	State of Israel Bond	Total
AAA	\$ 2,421,673	\$ 1,485,485	\$ -	\$ 401,514	\$ 840,315	\$ -	\$ 5,148,987
AA-	-	117,775	-	-	-	-	117,775
A+	-	305,579	-	-	-	-	305,579
A	-	1,167,770	30,625,611	-	-	-	31,793,381
A-	-	666,801	-	-	-	-	666,801
BBB+	-	683,006	-	-	-	-	683,006
BBB	-	625,569	-	-	-	-	625,569
BBB-	-	666,206	-	-	-	-	666,206
BB	-	190,080	-	-	-	-	190,080
B	-	129,973	-	-	-	-	129,973
Not Rated	-	-	-	-	-	250,000	250,000
Fair Value	\$ 2,421,673	\$ 6,038,244	\$ 30,625,611	\$ 401,514	\$ 840,315	\$ 250,000	\$ 40,577,357

* At Decemeber 31, 2004, the Fixed Income Mutual Fund had an average effective rating of A.

Concentration of Credit Risk

The City places no limit on the amount the government may invest in any one issuer. The City has 100% of its investments in MMDT.

More than 5 percent of the System's investments are in the following securities:

<u>Issuer</u>	<u>Percentage of Total Investments</u>
Loomis Sayles Fixed Income Mutual Fund.....	21.1%
UBS Real Estate Investors RESA Fund.....	6.9%
Rhumblin S&P 500 Pooled Index Fund.....	5.9%
	<u>33.9%</u>

NOTE 3 – RECEIVABLES

At June 30, 2005, receivables for the individual major governmental funds and non-major funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	Gross Amount	Allowance for Uncollectibles	Net Amount
<u>Receivables:</u>			
Real estate and personal property taxes....	\$ 1,913,626	\$ (537,714)	\$ 1,375,912
Tax liens and foreclosures.....	1,022,553	-	1,022,553
Motor vehicle excise taxes.....	2,659,003	(2,068,973)	590,030
User fees.....	7,969,905	-	7,969,905
Departmental and other.....	10,935,327	(9,399,072)	1,536,255
Intergovernmental.....	48,024,348	-	48,024,348
Loans.....	8,368,615	-	8,368,615
Total.....	<u>\$ 80,893,377</u>	<u>\$ (12,005,759)</u>	<u>\$ 68,887,618</u>

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. At the end of the current fiscal year, the various components of *deferred revenue* reported in the governmental funds were as follows:

	General Fund	Community Development	Water & Sewer	Nonmajor Governmental Funds	Total
<u>Receivable type:</u>					
Real estate and personal property taxes....	\$ 1,240,472	\$ -	\$ -	\$ -	\$ 1,240,472
Tax liens and foreclosures.....	1,022,553	-	-	-	1,022,553
Motor vehicle excise.....	590,030	-	-	-	590,030
User fees.....	2,347,903	-	5,622,002	-	7,969,905
Departmental and other.....	1,536,255	-	-	-	1,536,255
Intergovernmental.....	35,361,000	8,957,242	-	2,591,803	46,910,045
Total.....	<u>\$ 42,098,213</u>	<u>\$ 8,957,242</u>	<u>\$ 5,622,002</u>	<u>\$ 2,591,803</u>	<u>\$ 59,269,260</u>

NOTE 4 – CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2005, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental Activities:				
<u>Capital assets not being depreciated:</u>				
Land.....	\$ 10,156,359	\$ -	\$ (9,690)	\$ 10,146,669
Construction in progress.....	182,690	1,102,642	(182,690)	1,102,642
Total capital assets not being depreciated.....	<u>10,339,049</u>	<u>1,102,642</u>	<u>(192,380)</u>	<u>11,249,311</u>
<u>Capital assets being depreciated:</u>				
Land improvements.....	13,083,305	334,854	(18,579)	13,399,580
Books and periodicals.....	1,868,796	156,804	-	2,025,600
Buildings and improvements.....	117,140,840	24,502	(138,895)	117,026,447
Machinery and equipment.....	4,324,221	1,278,945	(369,056)	5,234,110
Vehicles.....	7,661,439	654,437	(712,371)	7,603,505
Infrastructure.....	<u>50,798,141</u>	<u>3,556,996</u>	<u>(189,192)</u>	<u>54,165,945</u>
Total capital assets being depreciated.....	<u>194,876,742</u>	<u>6,006,538</u>	<u>(1,428,093)</u>	<u>199,455,187</u>
<u>Less accumulated depreciation for:</u>				
Land improvements.....	(4,045,932)	(484,728)	6,880	(4,523,780)
Books and periodicals.....	(1,030,352)	(166,580)	-	(1,196,932)
Buildings and improvements.....	(32,960,904)	(3,075,277)	109,449	(35,926,732)
Machinery and equipment.....	(3,301,480)	(691,854)	359,631	(3,633,703)
Vehicles.....	(6,033,365)	(389,150)	588,402	(5,834,113)
Infrastructure.....	<u>(37,433,857)</u>	<u>(517,944)</u>	<u>189,192</u>	<u>(37,762,609)</u>
Total accumulated depreciation.....	<u>(84,805,890)</u>	<u>(5,325,533)</u>	<u>1,253,554</u>	<u>(88,877,869)</u>
Total capital assets being depreciated, net.....	<u>110,070,852</u>	<u>681,005</u>	<u>(174,539)</u>	<u>110,577,318</u>
Total governmental activities capital assets, net.....	<u>\$ 120,409,901</u>	<u>\$ 1,783,647</u>	<u>\$ (366,919)</u>	<u>\$ 121,826,629</u>

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities:	
General government.....	\$ 200,723
Public safety.....	675,052
Education.....	2,942,215
Public works.....	893,840
Human services.....	1,812
Culture and recreation.....	<u>611,891</u>
 Total depreciation expense - governmental activities.....	 \$ <u><u>5,325,533</u></u>

NOTE 5 – INTERFUND TRANSFERS

Interfund transfers for the fiscal year ended June 30, 2005, are summarized as follows:

	<u>Operating Transfers In:</u>
<u>Operating Transfers Out:</u>	<u>Nonmajor Governmental Fund</u>
General Fund.....	\$ <u><u>924,277</u></u>

Transfers relate to amounts voted to fund the fiscal year 2005 budget as well as the close out of certain funds maintained within the general ledger.

NOTE 6 – LEASES

Operating Leases

The City leases three buildings and a licensed parking area under several noncancelable operating leases. The total cost of these leases for the fiscal year ended June 30, 2005, totaled \$823,709 and is reported as general government and education expenditures in the basic financial statements. The future minimum lease payments are as follows:

<u>Fiscal Years Ending June 30</u>	<u>Governmental Activities</u>
2006.....	\$ 916,931
2007.....	352,120
2008.....	<u>49,183</u>
 Total.....	 \$ <u><u>1,318,234</u></u>

NOTE 7 – SHORT-TERM FINANCING

Short-term debt may be authorized and issued to fund the following:

- Current operating costs prior to the collection of revenues through issuance of revenue or tax anticipation notes (RANS or TANS).
- Capital project costs and other approved expenditures incurred prior to obtaining permanent financing through issuance of bond anticipation notes (BANS) or grant anticipation notes (GANS).

Short-term loans are general obligations and carry maturity dates that are limited by statute. Interest expenditures and expenses for short-term borrowings are accounted for in the general fund and capital projects fund, respectively.

Details related to the short-term debt activity for the fiscal year ended June 30, 2005, is as follows:

Type	Purpose	Rate (%)	Due Date	Balance at June 30, 2004	Renewed/ Issued	Retired/ Redeemed	Balance at June 30, 2005
BAN	Engineering & Architecture.....	1.03	08/20/04	\$ 1,300,000	\$ -	\$ 1,300,000	\$ -
BAN	Electrical Upgrades.....	1.03	08/20/04	502,000	-	502,000	-
BAN	Building Renovations.....	1.03	08/20/04	3,750,000	-	3,750,000	-
BAN	Sewer Construction.....	1.03	08/20/04	1,400,000	-	1,400,000	-
BAN	Equipment.....	1.41	08/20/04	1,100,000	-	1,100,000	-
BAN	Sewer Construction.....	1.41	08/20/04	800,000	-	800,000	-
BAN	Lincoln Park School.....	2.75	08/20/05	-	1,300,000	-	1,300,000
BAN	High School Renovations.....	2.75	08/20/05	-	502,000	-	502,000
BAN	Sewer Construction.....	2.75	08/20/05	-	2,200,000	-	2,200,000
BAN	Homen's Renovation (2).....	2.75	08/20/05	-	260,000	-	260,000
BAN	School Renovations.....	2.75	08/20/05	-	100,000	-	100,000
BAN	Equipment.....	2.75	08/20/05	-	1,100,000	-	1,100,000
BAN	Powder House Renovations.....	2.75	08/20/05	-	700,000	-	700,000
Total.....				\$ 8,852,000	\$ 6,162,000	\$ 8,852,000	\$ 6,162,000

On August 20, 2005 the City retired \$82,000 and rolled over \$6,080,000 of the BANS outstanding at an interest rate of 4.00%, due on 8/18/06.

NOTE 8 - LONG-TERM DEBT

Under the provisions of Chapter 44, Section 10, Municipal Law authorizes indebtedness up to a limit of 5% of the equalized valuation. Debt issued in accordance with this section of the law is designated as being "inside the debt limit". In addition, however, debt may be authorized in excess of that limit for specific purposes. Such debt, when issued, is designated as being "outside the debt limit".

In prior years, certain general obligation bonds were defeased by placing the proceeds of bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. At June 30, 2005, approximately \$2,250,000 of bonds outstanding from the advance refunding is considered defeased.

Details related to the outstanding indebtedness at June 30, 2005, and the debt service requirements are as follows:

Bonds and Notes Payable Schedule – Governmental Funds

Project	Interest Rate (%)	Outstanding at June 30, 2004	Issued	Redeemed	Outstanding at June 30, 2005
Municipal Purpose November 15, 1995.....	5.33%	\$ 690,000	\$ -	\$ 690,000	\$ -
Municipal Purpose April 1, 1998.....	4.83%	14,830,000	-	925,000	13,905,000
Municipal Purpose February 15, 1997.....	5.29%	15,020,000	-	915,000	14,105,000
Water Projects - July 1, 1996.....	5.35%	220,000	-	110,000	110,000
Sewer Projects - July 1, 1996.....	5.35%	230,000	-	115,000	115,000
MWRA Notes.....	0.00%	3,223,380	1,178,828	379,221	4,022,987
Municipal Purpose February 15, 2002.....	4.50%	24,795,000	-	1,145,000	23,650,000
General Obligation Bond March 15,2004....	4.00%	10,355,000	-	125,000	10,230,000
Total bonds and notes payable.....		69,363,380	1,178,828	4,404,221	66,137,987
Section 108 Intergovernmental					
Loans.....	7.12%-8.00%	2,900,000	-	280,000	2,620,000
Total.....		\$ 72,263,380	\$ 1,178,828	\$ 4,684,221	\$ 68,757,987

Debt service requirements for principal and interest for Governmental bonds payable in future fiscal years are as follows:

Fiscal Year	Principal	Interest	Total
2006.....	\$ 4,880,180	\$ 3,131,374	\$ 8,011,554
2007.....	4,950,182	2,800,591	7,750,773
2008.....	5,215,180	2,592,055	7,807,235
2009.....	5,320,180	2,402,593	7,722,773
2010.....	5,175,180	2,211,553	7,386,733
2011.....	5,244,027	2,003,467	7,247,494
2012.....	5,304,224	1,791,632	7,095,856
2013.....	5,034,417	1,585,955	6,620,372
2014.....	5,029,612	1,361,040	6,390,652
2015.....	4,869,805	1,125,064	5,994,869
2016.....	4,305,000	895,070	5,200,070
2017.....	4,210,000	677,360	4,887,360
2018.....	2,810,000	461,000	3,271,000
2019.....	1,580,000	320,500	1,900,500
2020.....	1,540,000	241,500	1,781,500
2021.....	1,610,000	164,500	1,774,500
2022.....	1,680,000	84,000	1,764,000
Total.....	\$ 68,757,987	\$ 23,849,254	\$ 92,607,241

The Massachusetts Water Resource Authority (MWRA) operates an Infiltration/Inflow Financial Assistance Program for community owned collection systems. For each community approved for the project, financial assistance received from the MWRA consists of a non-interest bearing loan. During fiscal year 2005, \$1,255,766 was received from this program; of this \$76,938 was a grant. The loan is payable in ten equal annual installments. At June 30, 2005, the outstanding principal amount of these loans totaled \$4,022,987.

The Commonwealth has approved school construction assistance. The assistance program, which is administered by the Massachusetts School Building Authority, provides resources for future debt service of general obligation school bonds outstanding. During fiscal year 2005 approximately \$3,736,000 of such assistance was received. Approximately \$54,324,000 will be received in future fiscal years. Of this amount, approximately \$18,963,000 represents reimbursement of long-term interest costs, and approximately \$35,361,000 represents reimbursement of approved construction costs. Accordingly, a \$35,361,000 intergovernmental receivable and corresponding deferred revenue have been reported in governmental fund financial statements. The deferred revenue has been recognized as revenue in the conversion to the government-wide financial statements.

The City receives loans under Section 108 of the Federal housing and Community Development Act of 1974. Loan proceeds, recorded as an other financing source in the Special Revenue Fund when received, are being used for the revitalization of Boynton yards. The loans are secured by present and future grants under Section 106 of Title 1 or program income derived from the sale of real property. Payments on these loans are reported in the Special Revenue Fund as debt service expenditures in the fiscal year of payment.

The City is subject to various debt limits by statute and may issue additional general obligation debt under the normal debt limit. At June 30, 2005, the City had the following authorized and unissued debt:

Purpose	Amount
Lincoln Park School Project.....	\$ 22,100,000
Powder House Building.....	5,800,000
Water.....	948,053
Highways.....	915,000
Street Signals.....	810,000
Sidewalks.....	400,000
Water/Sewer/Drainage.....	375,000
Sewer.....	1,074,475
School Renovations.....	150,000
Communications & Equipment.....	55,000
 Total.....	 \$ <u>32,627,528</u>

Changes in Long-term Liabilities

During the fiscal year ended June 30, 2005, the following changes occurred in long-term liabilities:

	Balance June 30, 2004	Additions	Reductions	Balance June 30, 2005	Current Portion
Governmental Activities:					
Long-Term Bonds and Notes.....	\$ 69,363,380	\$ 1,178,828	\$ (4,404,221)	\$ 66,137,987	\$ 4,880,180
Long-Term Intergovernmental Loans...	2,900,000	-	(280,000)	2,620,000	280,000
Workers' Compensation.....	429,000	1,382,000	-	1,811,000	181,100
Compensated Absences.....	2,600,000	-	(213,000)	2,387,000	238,700
Total.....	<u>\$ 75,292,380</u>	<u>\$ 2,560,828</u>	<u>\$ (4,897,221)</u>	<u>\$ 72,955,987</u>	<u>\$ 5,579,980</u>

NOTE 9 – RISK FINANCING

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the City carries commercial insurance.

The City is self-insured for its retirees' health insurance and workers' compensation activities. These activities are accounted for in the General Fund. Liabilities, including amounts Incurred But Not Reported (IBNR), are recorded when the claim is incurred.

(a) *Health Insurance*

The estimate of Incurred But Not Reported (IBNR) claims based on a three month claims paid average. At June 30, 2005, the amount of the liability for health insurance claims totaled \$1,679,000. This liability is the best estimate based on available information. Changes in the reported liability since July 1, 2003, are as follows:

	Balance at Beginning of Fiscal Year	Current Year Claims and Changes in Estimate	Claims Payments	Balance at Fiscal Year-End
Fiscal Year 2004.....	\$ 1,133,000	\$ 21,917,420	\$ (20,763,420)	\$ 2,287,000
Fiscal Year 2005.....	2,287,000	21,431,889	(22,039,889)	1,679,000

(b) *Workers' Compensation*

Workers' compensation claims are administered by a third party administrator and are funded on a pay-as-you-go basis from annual appropriations. The estimated future workers' compensation liability is based on history and injury type. At June 30, 2005, the amount of the liability for workers' compensation claims totaled \$1,811,000. Changes in the reported liability since July 1, 2003, are as follows:

	Balance at Beginning of Fiscal Year	Current Year Claims and Changes in Estimate	Claims Payments	Balance at Fiscal Year-End
Fiscal Year 2004.....	\$ 1,044,000	\$ (74,913)	\$ (540,087)	429,000
Fiscal Year 2005.....	429,000	1,869,501	(487,501)	1,811,000

NOTE 10 - PENSION PLAN

Plan Description - The City contributes to the System, a cost-sharing multiple-employer defined benefit pension plan administered by the Somerville Contributory Retirement Board. Substantially all employees are members of the System, except for public school teachers and certain administrators who are members of the Massachusetts Teachers Retirement System, to which the City does not contribute. Pension benefits and administrative expenses paid by the Teachers Retirement Board are the legal responsibility of the Commonwealth. The amount of these on-behalf payments totaled \$8,802,930 for the fiscal year ended June 30, 2005, and, accordingly, are reported in the general fund as intergovernmental revenues and pension expenditures.

The System provides retirement, disability and death benefits to plan members and beneficiaries. Chapter 32 of the MGL assigns authority to establish and amend benefit provisions of the plan. Cost-of-living adjustments granted between 1981 and 1997 and any increase in other benefits imposed by the Commonwealth's state law during those years are borne by the Commonwealth and are deposited into the pension fund. Cost-of-living adjustments granted after 1997 must be approved by the Somerville Contributory Retirement Board and are borne by the System. The System issues a publicly available unaudited financial report in accordance with guidelines established by the Commonwealth's PERAC. That report may be obtained by contacting the System located at 50 Evergreen Avenue, Somerville, Massachusetts 02145.

At December 31, 2004, the System's membership consists of the following:

Active members.....	1107
Inactive members.....	289
Retirees and beneficiaries currently receiving benefits.....	<u>985</u>
Total.....	<u>2381</u>

Funding Policy - Plan members are required to contribute to the System at rates ranging from 5% to 11% of annual covered compensation. The City is required to pay into the System its share of the system-wide actuarial determined contribution that is apportioned among the employers based on active current payroll. Administrative expenses are funded through investment earnings. The current and two preceding fiscal years apportionment of the annual pension cost between the two employers required the City to contribute approximately 93% of the total. Chapter 32 of the MGL governs the contributions of plan members and the City.

Annual Pension Cost - The City's contributions to the System for the fiscal years ended June 30, 2005, 2004, and 2003 were \$9,588,751, \$8,622,772, and \$8,341,643, respectively, which equaled its required contribution for each fiscal year. At June 30, 2005, the City did not have a net pension obligation. The required contribution was determined as part of the January 1, 2004, actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included an 8.25% investment rate of return and projected salary increases of 5.00% per year. The actuarial value of the System's assets was determined using the fair value of the assets. The System's unfunded actuarial accrued liability is being amortized as a level percentage of projected payrolls. The remaining amortization period at January 1, 2005, was 20 years.

Schedule of Funding Progress (Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) Entry Age (B)	Unfunded AAL (UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll ((B-A)/C)
01/01/04	\$ 145,900	\$ 246,900	\$ 101,000	\$ 59.1%	\$ 43,900	230.1%
01/01/01	134,400	204,500	70,100	65.7%	44,800	156.5%
01/01/98	103,300	168,700	65,400	61.2%	39,000	167.7%
01/01/97	89,400	137,700	48,300	64.9%	36,750	131.4%
01/01/96	79,500	136,900	57,400	58.1%	33,630	170.7%
01/01/95	66,400	127,200	60,800	52.2%	35,700	170.3%
01/01/94	68,000	121,700	53,700	55.9%	27,200	197.4%

Funding progress is reported based on the biennial actuarial valuation performed by the System, and is being accumulated on a biennial basis. The City is responsible for approximately 34% of the unfunded liability.

Noncontributory Retirement Allowance – The City pays the entire retirement allowance for certain retirees who are eligible for noncontributory benefits and are not members of the System. The general fund expenditure for fiscal year 2005 totaled approximately \$515,000.

NOTE 11 - COMMITMENTS

The City has entered into an agreement with Waste Management of Massachusetts, Inc. to direct the acceptable waste it collects to a transfer station. The City is charged a flat rate per ton that is subject to increase annually equal to but not to exceed any average net increase in the Consumer Price Index for Urban Wage Earners. There are no minimum tonnage requirements that the City must comply with.

The School Department has entered into an agreement with TransComm, Inc. to provide for the transportation of its students. The contract bears an annual cost of approximately \$1,300,000 and expires on June 30, 2007.

The City has entered into, or is planning to enter into, contracts totaling approximately \$33,000,000 for the reconstruction of the Lincoln School, for the renovation of the Homens building, for the renovation of the Powder House building and for various street and sidewalk projects throughout the City.

NOTE 12 - CONTINGENCIES

The City participates in a number of federal award programs. Although the grant programs have been audited in accordance with the provisions of the Single Audit Act Amendments of 1996 through June 30, 2005, these programs are still subject to financial and compliance audits. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although it is expected such amounts, if any, to be immaterial.

Various legal actions and claims are pending. Litigation is subject to many uncertainties, and the outcome of individual litigated matters is not always predictable. Although the amount of liability, if any, at June 30, 2005, cannot be ascertained, management believes any resulting liability should not materially affect the financial position at June 30, 2005.

NOTE 13 – FUTURE IMPLEMENTATION OF NEW GASB PRONOUNCEMENTS

During fiscal year 2005, the following GASB pronouncements were implemented:

The GASB issued Statement #40, Deposit and Investment Risk Disclosures, an Amendment of GASB Statement #3. This pronouncement only required changes to the note disclosure.

Other Future GASB Pronouncements:

The GASB issued Statement #42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, which is required to be implemented in Fiscal 2006. Management does not believe that this pronouncement will significantly impact the basic financial statements.

The GASB issued Statement #43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, which is required to be implemented in Fiscal 2007. Since there is no legally established separate trust for the postemployment benefit plan this pronouncement will not impact the basic financial statements.

The GASB issued Statement #44, Economic Condition Reporting: The Statistical Section, which is required to be implemented in Fiscal 2006. This new GASB establishes and modifies requirements related to supplementary information presented in a statistical section. The presentation of a statistical section is not required by this pronouncement. This pronouncement will not impact the basic financial statements.

The GASB issued Statement #45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, which is required to be implemented in Fiscal 2008. Management believes this pronouncement will require additional disclosure and impact the basic financial statements.

The GASB issued Statement # 46, Net Assets Restricted by Legislation an amendment of GASB Statement No. 34. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. It requires governments to disclose the portion of total net assets that is restricted by enabling legislation. This statement is required to be implemented in FY2006. Management believes that this statement will not effect on the basic financial statements.

The GASB issued Statement # 47, Accounting for Termination Benefits. The Statement provides accounting and reporting guidance for state and local governments that offer benefits such as early retirement incentives or severance to employees that are involuntarily terminated. The Statement requires that similar forms of termination benefits be accounted for in the same manner and is intended to enhance both the consistency of reporting for termination benefits and the comparability of financial statements. This statement is required to be implemented in FY2006. Management believes that this statement will not effect on the basic financial statements.

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Required Supplementary Information

GENERAL FUND
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL

FISCAL YEAR ENDED JUNE 30, 2005

	Budgeted Amounts			
	Amounts Carried forward From Prior Year	Current Year Initial Budget	Original Budget	Final Budget
REVENUES:				
Real estate and personal property taxes, net of tax refunds.....	\$ -	\$ 73,246,633	\$ 73,246,633	\$ 73,246,633
Tax liens.....	-	-	-	-
Motor vehicle and other excise taxes.....	-	4,858,624	4,858,624	4,858,624
Intergovernmental.....	-	51,328,968	51,328,968	51,328,968
Departmental and other.....	-	11,608,851	11,608,851	11,608,851
Investment income.....	-	450,000	450,000	450,000
TOTAL REVENUES.....	-	141,493,076	141,493,076	141,493,076
EXPENDITURES:				
Current:				
General government.....	413,243	8,730,776	9,144,019	8,842,091
Public safety.....	85,472	24,490,408	24,575,880	25,260,361
Education.....	411,131	44,000,000	44,411,131	44,329,187
Public works.....	633,025	16,122,615	16,755,640	17,330,429
Culture and recreation.....	7,154	2,239,117	2,246,271	2,243,276
Pension benefits.....	-	9,830,116	9,830,116	10,088,447
Employee benefits.....	13,278	24,538,833	24,552,111	23,649,834
State and county charges.....	-	8,954,713	8,954,713	8,954,713
Debt service:				
Principal.....	-	3,703,421	3,703,421	3,703,421
Interest.....	-	3,117,635	3,117,635	3,117,635
TOTAL EXPENDITURES.....	1,563,303	145,727,634	147,290,937	147,519,394
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES.....	(1,563,303)	(4,234,558)	(5,797,861)	(6,026,318)
OTHER FINANCING SOURCES (USES):				
Sale of capital assets.....	-	-	-	-
Operating transfers in.....	-	493,922	493,922	918,922
TOTAL OTHER FINANCING SOURCES (USES).....	-	493,922	493,922	918,922
NET CHANGE IN FUND BALANCE.....	(1,563,303)	(3,740,636)	(5,303,939)	(5,107,396)
BUDGETARY FUND BALANCE, Beginning of year.....	-	14,427,347	14,427,347	14,427,347
BUDGETARY FUND BALANCE, End of year.....	\$ (1,563,303)	\$ 10,686,711	\$ 9,123,408	\$ 9,319,951

See notes to basic financial statements.

	Actual Budgetary Amounts	Amounts Carried Forward To Next Year	Variance Final Budget
\$	72,674,214	\$ -	\$ (572,419)
	1,144,242	-	1,144,242
	5,379,484	-	520,860
	52,783,382	-	1,454,414
	12,689,433	-	1,080,582
	613,010	-	163,010
	<u>145,625,584</u>	<u>-</u>	<u>4,132,508</u>
	7,512,721	1,124,644	204,726
	24,624,428	552,831	83,102
	43,971,831	319,820	37,536
	16,316,429	577,934	436,066
	2,199,110	2,144	42,022
	10,104,148	-	(15,701)
	23,561,187	-	88,647
	8,134,727	-	819,986
	3,703,421	-	-
	3,014,313	-	103,322
	<u>143,142,315</u>	<u>2,577,373</u>	<u>1,799,706</u>
	<u>2,483,269</u>	<u>(2,577,373)</u>	<u>5,932,214</u>
	1,234,671	-	1,234,671
	924,277	-	5,355
	<u>2,158,948</u>	<u>-</u>	<u>1,240,026</u>
	4,642,217	(2,577,373)	7,172,240
	14,427,347	-	-
\$	<u><u>19,069,564</u></u>	<u><u>(2,577,373)</u></u>	<u><u>7,172,240</u></u>

Notes to Required Supplementary Information**A. Budgetary Information**

Municipal Law requires the adoption of a balanced budget that is approved by the Mayor and the Board. The Mayor presents an annual budget to the Board, which includes estimates of revenues and other financing sources and recommendations of expenditures and other financing uses. The Board, which has full authority to amend and/or reject the budget or any line item, adopts the expenditure budget by majority vote.

Increases or transfers between and within departments subsequent to the approval of the annual budget, requires majority Board approval via a supplemental appropriation or Board order.

The majority of appropriations are non-continuing which lapse at the end of each fiscal year. Others are continuing appropriations for which the governing body has authorized that an unspent balance from a prior fiscal year be carried forward and made available for spending in the current fiscal year. These carry forwards are included as part of the subsequent fiscal year's original budget.

Generally, expenditures may not exceed the legal level of spending (salaries, expenses and capital) authorized for an appropriation account. However, the payment of debt service is statutorily required, regardless of whether such amounts are appropriated. Additionally, expenditures for disasters, natural or otherwise, and final judgments may exceed the level of spending authorized by two-thirds majority vote of the Board.

An annual budget is adopted for the general fund in conformity with the guidelines described above. The original fiscal year 2005 approved budget authorized \$147,290,937 in appropriations and other amounts to be raised. During fiscal year 2005, the Board also increased appropriations totaling \$228,457.

The City Auditor's office has the responsibility to ensure that budgetary control is maintained. Budgetary control is exercised through the accounting system.

B. Budgetary - GAAP Reconciliation

For budgetary financial reporting purposes, the Uniform Municipal Accounting System basis of accounting (established by the Commonwealth) is followed, which differs from the GAAP basis of accounting. A reconciliation of budgetary-basis to GAAP-basis results for the general fund for the fiscal year ended June 30, 2005, is presented below:

Excess (deficiency) of revenues and other financing sources (uses) over expenditures - budgetary basis.....	\$ 4,642,217
<u>Perspective difference:</u>	
Unemployment insurance trust recorded in the General Fund for GAAP.....	3,695,340
<u>Basis of accounting differences:</u>	
Net change in recording 60-day receipts accrual.....	19,735
Net change in recording tax refunds payable.....	(95,000)
Net change in recording unrecorded liabilities.....	(125,936)
Short-term interest accrual.....	(145,778)
Recognition of revenue for on-behalf payments.....	8,802,930
Recognition of expenditures for on-behalf payments.....	<u>(8,802,930)</u>
Excess (deficiency) of revenues and other financing sources (uses) over expenditures - GAAP basis.....	<u>\$ 7,990,578</u>

C. Appropriation Deficits

During fiscal year 2005, expenditures exceeded budgeted appropriations for pension benefits. This deficit will be funded through tax levy in fiscal year 2006.